$.50/pack lower than regular Marlboro, but which can move up or down in price in tandem with deep-discount prices). The introduction of a Marlbor fighter brand, which would likely be copied by each of Philip Morris' competitors, could allow the industry to return to an environment of norm profit growth as discount brands disappear, and as premium brand pricing flexibility resumes.

8. Importance of Nielsen Data: Over the next few months, two pieces of data that come from Nielsen will be most important in our efforts to determine whether the new Marlboro pricing strategy is working: (1) Retail price gap between Marlboro and the deep-discount brands, and (2) Marlboro's retail takeaway share. The Nielsen data tracks 55%-60% of total industry volume, measuring retail takeaway in food, drug, and large convenience store chains. While not perfect, the data has correctly predicted the explosion in deep-discount brand share, the collapse of the mid-priced segment, and now, the sharp deterioration in Marlboro volumes. We will continue to publish this data on a bi-monthly basis (6-8 weeks after the end of the period).

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END OF NOTE

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to close the dead net differential between Marlboro and the deep-discount brands. While we agree that Philip Morris had to do something to stop Marlboro's share erosion, our bet is that players with strong discount brand positions (BAT, AMB) will likely move to protect their discount brand franchises with increased retail buy-downs and promotional allowances of their own. The net result could be a ratcheting down of the entire pricing structure -- with no effective closing of the gap between Marlboro and the deep-discount brands. Our forecast remains that Marlboro shipments will decline by 6-7% in 1993, and by 8-10% per year thereafter.

5. Risk of Low-End Disruption Increasing. Historically, we have seen new lower-tier segments emerge when the net list of the lowest-priced brands reached twice variable costs (including marketing). We have passed that point. We estimate that variable costs are now running at about $.25-$.27/pack for the smaller players; the net list price on the low-priced brands is now $.55/pack ($.48/pack after allowances). The net list price has increased from $.34/pack in October, 1992.

   Liggett has been the big loser in the deep-discount share war (6.6% share JF'93 vs. 25.3% share JF'92). BAT's share of the deep-discount segment is also now falling (21.6% in JF'93 vs. 26.6% in JF'92). MO and RJR have clearly gained control of the low-priced segment, as their collective share increased to 69% in JF'93, vs. 48% in JF'92.

Black & White Retail Takeaway

Share of Segment	JF'92	JF'93	Pt Chg
MO and RJR Combined	48.1%	68.8%	20.7
Brown & Williamson (BAT)	26.6	21.6	(5.0)
American Brands	-	3.0	3.0
Liggett	25.3	6.6	(18.7)
Total Industry	100.0%	100.0%	-

6. American Brands: New Strategy Has Stopped The Bleeding. American Brands' volumes continued to decline, falling -11% in JF'93, following consecutive (11%)-(13%) declines in the four prior bimonthlies. As announced after the 4th Quarter, American Brands is now using buy-downs aggressively to ensure that three of its' mid-priced brands -- Misty, Montclair, and Riviera -- are being priced no higher than competitors' low-priced brands. The new strategy appears to be taking hold: AMB's mid-priced volumes fell a mere -14% in JF'93, vs. an overall mid-priced segment decline of -31% in JF'93). Given Philip Morris' move to discount Marlboro by up to $.40/pack, and some recent indications that Philip Morris' competitors may be moving to match the American Brands' buy-downs, we may be nearing the point where the mid-priced and deep-discount segments converge at the lower price.

7. The Price War: One Possible Scenario. At some point, we expect Philip Morris to realize that the pricing action outlined on "Marlboro Friday" may not result in material market share gains. We maintain that Philip Morris' competitors, who require continued growth in their discount brands to maintain (let alone grow) overall market share, are unlikely to sit back and allow Philip Morris to take their discount shares. The likelihood of new disruption in the deep discount segment, combined with a evolving strategy by the convenience store operators to develop and market their own exclusive store brands as loss leaders, limits the likelihood of Marlboro success in closing the price gap vs. deep-discount brands. Ultimately, we could see Philip Morris move to a true Marlboro "fighter brand" line extension (e.g. a shorter Marlboro priced initially at

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WIC: Pls call me when you've had a chance to digest, and bring me up to date on our perspective/situation Thanks

12:10pm EDT 20-Apr-93 Bernstein (GARY BLACK 212-756-4197) MO AMB
NEILSEN SHARES JAN-FEB:BLACK & WHITE NOW 21%;PREMIUMS DOWN 15%;MARLBORO DOWN 11

	4/19 Price	YTD Perf.	EPS 1992A	EPS 1993E	EPS 1994E	P/E 1993E	P/E 1994E	'93-97E CGR %	Curr Yield
AMB	$32	-22	$4.13	$3.60	$3.70	8.8	8.5	6	6.3%
MO	49	-37	5.45	4.75	5.10	10.3	9.6	12	5.3
SPX	447	+3	23.65	25.50	28.25	16.1	15.6	7	2.8

NYM 4/21

* Fully diluted before non-recurring items

HIGHLIGHTS

1. Low-priced segment growth continues to explode: 21.3% share in JF'93 vs. 7.2% in JF'92 (18.5% in ND'92). Total discount segment now 35%.

2. Premium segment decline is accelerating: Down -15% in JF'93 (largest decline to-date), following three periods of 11%-12% declines.

3. Marlboro volumes down -11% in JF'93 (first double-digit decline), following -7% decline in ND'92 (data covers 55%-60% of industry volume). Philip Morris' internal numbers will likely show Marlboro consumption down 8%-9% year-to-date (2-point bias vs. Nielsen).

4. There is increasing probability of new pricing disruption in the low-end: Liggett volumes are plunging (-30% in JF'93, -24% in ND'92); Brown & Williamson's share of deep-discount segment is eroding.

5. AMB's new strategy to support its mid-priced brands appears to have stopped the bleeding (-11% overall volume decline in JF'93); AMB premium volumes, however, continue to fall sharply (-22% in JF'93).

6. Philip Morris' decision to reduce dead nets on Marlboro by $.40/pack is likely to cause the mid- and low-priced (deep-discount) segments to converge. With new disruption in the low-end likely, Marlboro's plan to narrow the net price differential (vs. deep discounts) could fail.

INVESTMENT CONCLUSIONS

1. **Philip Morris: Market-perform.** The risk-return trade-off inherent in MO's stock price has become more attractive. Longer-term, the stock looks cheap: the current price is discounting less than 5% earnings growth (to be ranked in first quintile); we are projecting 10-12% growth post-1994. During the next 6-12 months, however, unfavorable revisions trends and the twin uncertainties of the domestic cigarette price war and increased excise taxes are the bases for our market-perform rating.

2. **American Brands: Market-perform.** Of the three cigarette stocks, American Brands offers the least upside but also the lowest amount of risk. AMB's $1.97 dividend (6.3% yield, with a 6-8% increase likely in 4Q), and AMB's considerable value excluding domestic tobacco ($28-$30/share, net of debt) could provide a valuation floor for this stock. Still, AMB's domestic tobacco unit is likely to suffer most in a price war, given AMB's high dependence on the mid-priced segment, which could disappear once Marlboro cuts dead nets.

DETAILS

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Source: https://www.industrydocuments.ucsf.edu/docs/zykm0000

1. The premium segment registered its steepest decline yet in JF'93, dropping by -15%, after posting 11-12% declines during the previous three bi-monthlies. The premium segment fell to a 65% share vs. 74% in JF'92 (our 1993FY forecast is 65%). Convenience stores operators have so far largely ignored the $.21/pack (60%) increase in list prices taken on the deep-discount brands since November; one big reason is that many are using deep-discount cigarettes as loss leaders to gain retail volume. As a result, the retail price differential between premium- and low-priced brands has narrowed by just $.04/pack during this period (to $.73/pack pre-coupon):

	JF'92	MA'92	MJ'92	JA'92	SO'92	ND'92	JF'93
Premium segment							
% Chg vs prior yr	-7%	-7%	-9%	-11%	-12%	-11%	-15%
Retail price diff'l							
$ per pack	$.55	$.57	$.64	$.69	$.75	$.77	$.73E

2. Deep-discount (black & white) share growth continues to accelerate at retail and now accounts for 21.3% of volume (+14.1 pts vs. year ago). The growth in black & whites has been fueled by strong distribution gains across all classes of trade -- particularly convenience stores, where deep-discount brands now hold a stunning 33% share (vs. just 12% in JF'92). The deep-discount segment is now taking more volume from the premium segment than from the mid-priced segment.

	JF'92	MA'92	MJ'92	JA'92	SO'92	ND'92	JF'93
Blk & white share	7.2%	8.4%	11.3%	14.4%	16.3%	18.5%	21.3%
Pt Chg vs prior yr	+2.7	+3.3	+6.0	+8.7	+10.3	+12.1	+14.1
Mid-priced share	19.1%	18.7%	17.6%	16.7%	15.1%	14.4%	13.6%
Pt Chg vs prior yr	+0.3	(0.7)	(2.0)	(2.7)	(4.5)	(5.9)	(5.5)
Premium share	73.7%	72.9%	71.1%	68.9%	68.6%	67.1%	65.1%
Pt Chg vs prior yr	(3.0)	(2.6)	(4.0)	(6.0)	(5.8)	(6.2)	(8.6)

3. Marlboro's consumption decline hits double-digits. Marlboro's retail takeaway fell -11% in JF'93 (Marlboro shipments are expected to be down -8% in 1Q). While clearly alarming, Marlboro's volume decline continues to perform about 3-4 pp better than the premium segment as a whole (down -15% in JF'93) Philip Morris' internal retail takeaway numbers for Marlboro are likely to show a (8%)-(9%) decline in JF'93, given Nielsen's apparent 2-point negative bias vs. Philip Morris' expanded Nielsen data base covering 80-85% of volume (our Nielsen data covers 55-60% of volume, comprised of food, drug, and large convenience/gas outlets).

	JF'92	MA'92	MJ'92	JA'92	SO'92	ND'92	JF'93
Marlboro consumption							
% Chg vs prior yr	0%	-2%	-5%	-7%	-9%	-7%	-11%
Marlboro share							
Pt Chg vs prior yr	+0.8	+0.5	(0.4)	(0.9)	(1.1)	(1.0)	(1.6)

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4. Commentary: Marlboro Strategy May Not Work. As we have stated previously, we remain unconvinced of the wisdom of Philip Morris' plan

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